Intelligence MEMOS

From: Don Drummond and Duncan Sinclair

To: Concerned Canadians

Date: March 2, 2022

Re: **Straight Talk About Healthcare Costs**

Total healthcare spending in Canada was $308 billion in 2021, according to Canadian Institute for Health Information (CIHI) estimates. That's up 15.3 percent ($40.8 billion) since 2019, swollen by $22.8 billion targeted at COVID-19.

This is not the real long-term problem.

Healthcare costs will increase more than 5 percent annually for years Canada's premiers predict. And the Parliamentary Budget Office uses a similar growth rate in its long-term projections. A 5- to 6-percent growth rate is plausible under the status quo.

But at the same time, growth in nominal output and government revenues, in the absence of tax increases, is likely to only be in the range of 3.5 percent.

This gap matters.

The differences between economic growth, government revenues and health funding are central to Canada's fiscal outlook, and, in the end, tax rates.

Every province and territory will need to find new sources of funds. The federal government is currently insulated through the limit on growth in the Canada Health Transfer to a moving average of growth in nominal GDP. But if it delivers on its commitment to increase that health transfer, and if the pending pharmacare plan is paid federally, Ottawa will also be stressed to find more money. The funding options are similar. As the saying goes, "there is only one taxpayer."

A funding crunch is inevitable under the status quo and one-time adjustments may not do the trick. If the gap persists between healthcare spending and revenue growth, tax rates are headed up.

Our forthcoming paper outlines some estimates of the possible increases in funding if governments resorted only to tax increases to finance healthcare cost growth as it outstrips economic growth.

Beginning with the provincial-territorial perspective, we present two healthcare spending scenarios over 15 years. The first is annual spending growth of 6 percent. The second is based on annual growth of 3.5 percent, equal to our estimate of nominal GDP growth (i.e., keeping the healthcare spending to GDP ratio constant). We benchmark both to CIHI's estimate of provincial-territorial pre-pandemic healthcare spending in 2019 ($172.9 billion).

From these scenarios we can answer the question: by how much would various provincial territorial taxes need to be raised to fund the difference between healthcare spending growing at 6 percent per annum and 3.5 per cent per annum? Implicit is the notion that the resultant P/T fiscal balances would be acceptable with healthcare spending growing at 3.5 percent per annum but that any additional spending would warrant a revenue response.

By year 15, healthcare spending would be $125 billion higher in the 6-percent growth scenario than under 3.5-percent growth. The cumulative difference in spending over the 15 years would be $737 billion or 19 percent of projected nominal GDP and this does not include induced interest on the public debt. Provinces likely hope to unwind the COVID-related increase in their debt burdens (on average across provinces, the latest provincial budgets show net debt-to-GDP ratios rising 6.2 percentage points of GDP from 2019-20 to 2022-23). Acquiescing to the higher healthcare spending would not only eliminate that but drive the debt burden to an all-time high in many provinces.

To offset the impact of the higher healthcare spending on deficits and debt, by year 15 an increase of almost 20 percent in total provincial tax revenue would be required; if provincial personal income taxes were used alone by year 15, they would need to be raised almost two-thirds above what they would yield in the status quo. Sales taxes would have to double if they were the only tool.

From a federal perspective, we consider growth of the Canada Health Transfer ($40.4 billion in 2019) in the same two scenarios. From the wide range of estimates for the cost of pharmacare, we use a middle-of-the-road figure of $20 billion in Year 1 and growth subsequently at 2 percent per annum. We have not included a cost for higher federal spending on mental health.

If federal personal income taxes were used to fund the incremental federal health spending, they would need to increase 20 percent by year 15. If instead the GST was used, the rate would need to increase from the current 5 percent to 7.8 percent by year five, 8.3 by year 10 and 8.9 by year 15.

Fundamental changes are needed.

Focusing more on health outcomes and containing costs through greater efficacy and efficiency represent the path forward. Failing the achievement of both, taxes must be raised and by a lot. Let the discussion/debate of these approaches begin now.

Don Drummond is Stauffer-Dunning Fellow and Adjunct Professor, School of Policy Studies, Queen's University where Duncan Sinclair is Professor emeritus.

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